

2010-2011 Top 10 Investor Traps

Products

Exchange-Traded Funds (ETFs). While ETFs resemble mutual funds in many respects, some, such as leveraged and inverse ETFs, may contain hidden traps and complexities, and may consist of highly leveraged bundles of exotic financial instruments. These volatile funds may not be suitable for most retail investors. Some ETFs are primarily designed for short-term trading, and not for buy-and-hold strategies. Also some ETFs are thinly traded and may not always be liquid.

Foreign Exchange Trading Schemes. Currency trading and foreign exchange (forex) trading schemes can be harmful to unsuspecting investors. Trading in foreign currencies requires resources far beyond the capacity of most individual investors. Promoters profit by charging high commissions or selling investment strategies assuming that trades are actually made. In some instances, there are no trades; the money is stolen.

Gold and Precious Metals. In gold bullion scams, a seller offers to retain “purchased” gold in a “secure vault” and promises to sell the gold for the investor when it gains in value. In many instances the gold does not exist. Investors also have been harmed by promoters pitching investment pools in precious metal commodities and gold mines.

Green Schemes. Investment opportunities tied to the development of new energy-efficient “green” technologies are increasingly popular. Scammers also exploit headlines, such as investments related to the clean-up of the Gulf of Mexico oil spill or in environmental innovations tied to “clean” energy.

Oil & Gas Schemes. Oil and gas investments tend to be highly risky and unsuitable for traditional, smaller investors who cannot afford the risk. Even when the underlying project is genuine, any revenues realized can be absorbed by high sales commissions and dubious “expenses.” Some promoters, many of whom have had past regulatory compliance problems, have attempted to structure their “joint ventures” or “general partnerships” to avoid securities regulation and deprive investors of important protections.

Practices

Affinity Fraud. Scam artists may use association with a group to convince an investor to trust the legitimacy of the investment. Typical affinity groups include religious, ethnic, professional, educational, language, age and any other group with shared characteristics that encourage trust. Investors should seek further information about the investment from an unbiased source and review the promises and risks.

Undisclosed Conflicts of Interest. Not all investment advice is given with the investor’s best interest at heart. Some salespeople can receive lucrative commissions when they sell a product that is risky or inappropriate, but don’t have to disclose that financial incentive. Investors should demand that anyone giving advice disclose how they are compensated.

Private or Special Deals. Some investors encounter investment opportunities couched as “private” or only for “special” clients. While securities laws do offer businesses the opportunity to raise capital by selling securities to a relatively small number of investors in a non-public offering, these securities are not subject to the same review as others. Although properly used by many legitimate issuers, regulators have seen abuse of fraudulent private offerings made under federal exemptions or not regulated at all.

“Off the Books” Deals. “Off the books” sales are an increasingly common threat to investors. Be cautious if your broker offers an investment on the side instead of one sold through his or her employer. These “off books” investments may lack oversight and supervision of the broker’s employer and may be illegal.

Unsolicited Online Pitches. In addition to e-mail solicitations, promoters use social media and online communities, such as Facebook, Twitter, Craigslist and YouTube to solicit investors. Some may use these sites to spread misinformation to artificially inflate the value of stock before selling in a “pump and dump” scheme. Others promise high-yield, tax-free returns from investments in offshore markets. Investors should approach any unsolicited investment opportunity with suspicion.

Contact the Department of Financial Institutions’ Securities Division at 800-223-2579 with any questions about an investment product, broker or adviser before investing.

